In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-838

JAMES TALCOTT, INC., PETITIONER

v.

IRVING L. WHARTON, TRUSTEE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION[1]

OPINIONS BELOW

The majority and dissenting opinions of the court of appeals (Pet. App. A) are reported at 517 F. 2d 997 and 1002. The opinion of the district court (Pet. App. E) is unreported.

[1]The Securities and Exchange Commission has been participating in these reorganization proceedings in the district court as a party pursuant to Section 208 of Chapter X of the Bankruptcy Act, 11 U.S.C. 608, since shortly after the proceedings commenced in 1963. It has taken positions in that court and in the court of appeals similar to the positions urged herein. As in *Protective Committee* v. *Anderson*, 390 U.S. 414, 420 n. 3, and *Caplin* v. *Marine Midland Grace Trust Co.*, 406 U.S. 416, 419 n. 8, the Commission is "an unnamed respondent before this Court." See Rule 21(4) of the Rules of this Court.

JURISDICTION

The judgment of the court of appeals was entered on June 5, 1975 (Pet. App. B). Orders denying rehearing and rehearing *en banc* were entered on September 16, 1975 (Pet. App. C and Pet. App. D, respectively). The petition for a writ of certiorari was filed on December 15, 1975. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether under the circumstances of this case a plan of reorganization under Chapter X of the Bankruptcy Act, 11 U.S.C. 501, *et seq.*, which provided for the consolidation of the assets and liabilities of two debtors, one of which was wholly owned by the other, is not "fair and equitable" within the meaning of Section 221(2) of Chapter X of the Bankruptcy Act because it precluded a secured creditor of both corporations from applying surplus collateral of the subsidiary toward the secured creditor's insufficiently collateralized claim against the parent.

STATUTE INVOLVED

Section 221 of the Bankruptcy Act, as added, 52 Stat. 897, 11 U.S.C. 621, provides in pertinent part:

> The judge shall confirm a plan if satisfied that—
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> (1) the provisions of article VII, section 199, and article X of this chapter have been complied with;
>
> (2) the plan is fair and equitable, and feasible;
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> * * * * *

STATEMENT

Petitioner, James Talcott, Inc. ("Talcott"), a factor, was the principal financier of Continental Vending Corporation ("Continental") and its wholly-owned subsidiary, Continental Apco, Inc. ("Apco"). Talcott advanced funds to

each of the corporations under separate security agreements, which provided that the collateral pledged by each corporation would be security for all present and future obligations of that company. The agreements made no provision for cross-collateralization and the companies did not guarantee each other's debts to petitioner (Pet. App. A10-A11).

Involuntary petitions under Chapter X of the Bankruptcy Act, 11 U.S.C. 501, *et seq.*, were separately filed against Continental and Apco, and there is a single trustee for both debtors. The trustee proposed a plan of reorganization which provided for a merger of the assets and liabilities of the two corporations and a consolidation of the proceedings. The trustee stated, *inter alia*, that (i) the operations of Continental and Apco constituted a single economic enterprise; (ii) there were guarantees and cross-guarantees by the debtors of many of each other's obligations and a complex pattern of transfers of funds between Continental and Apco, which depended wholly on Continental's needs; and (iii) the task of separating the assets and liabilities of the debtors or of reconstructing the inter-company financial transactions was virtually impossible regardless of the time, money and effort expended (CA App. 25a-26a).[2] A subsequent amended plan of reorganization provided, additionally, that claims against the debtors, except for claims of secured creditors, were to be treated on a consolidated basis. With respect to claims of secured creditors, the plan contained an express proviso against an elevation or improvement of the status of such claims as a result of the consolidation (CA App. 36a-37a). On May 20, 1971, the amended plan was approved by order on findings substantially conforming to the trustee's representations (CA App. 40a-41a).

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[2] "CA App." refers to the appendix filed in the court of appeals, a copy of which has been lodged with the Court.

After hearing, the district court confirmed the amended plan. The court of appeals affirmed and denied rehearing and rehearing *en banc*.

ARGUMENT

The decision of the court of appeals is correct and is not in conflict with the decisions of this Court or of any other court of appeals. The petition presents primarily a factual issue that does not warrant further review.

Although normally a reorganization requires a determination of what assets are subject to the payment of the respective claims, see *Consolidated Rock Products Co.* v. *Du Bois*, 312 U.S. 510, 520,[3] occasionally the expense and difficulty of making the required determination make it necessary simply to consolidate the assets of the separate corporate entities involved. See *Stone* v. *Eacho*, 127 F. 2d 284, 289 (C.A. 4), rehearing denied, 128 F. 2d 16, certiorari denied, 317 U.S. 635. While this alternative is not frequently used, see *Chemical Bank New York Trust Co.* v. *Kheel*, 369 F. 2d 845, 847 (C.A. 2); *Anaconda Building Materials Co.* v. *Newland*, 336 F. 2d 625 (C.A. 9), because of the potential inequities that may result to certain creditors, petitioner does not challenge the court's authority to order consolidation, nor does it challenge the appropriateness of consolidation in this case. The contention rather is that the district court abused its discretion in determining that the consolidation was appropriate only as to the claims of unsecured creditors.[4]

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[3]This holding was in the context of a "unified operation" of a parent and two subsidiary corporations that resulted in a "commingling of assets." *Id.* at 519. This Court determined that the reorganization court should find "some appropriate formula for at least an approximate ascertainment of their respective assets" in order fairly to compensate the bondholders of the two subsidiaries. *Id.* at 525.

[4]In his dissenting opinion, Judge Anderson states his agreement with the legal principles applied by the majority (see Pet. App. A17) and also predicates his dissent solely on the application of those principles to the facts (Pet. App. A9, A12, A17).

But the court determined there was no need for this unusual relief as to the claims of secured creditors because, as the court of appeals found (Pet. App. A4), there was "no evidence in the record that there were any intercompany transfers to the detriment of secured creditors * * *." Absent such a showing, consolidation as to secured creditors might result in permitting creditors of the parent corporation (who realized a deficiency on their security) to have a priority as to assets of the subsidiary, to the detriment of the latter's general creditors.

Under these circumstances, it was not an abuse of discretion for the court to order consolidation only with respect to the claims of the unsecured creditors.[5] Petitioner, which had obtained no cross guarantees on its separate security agreements, should not be permitted to apply assets subject to a lien against one debtor to its lien against the other. Under the plan for liquidation, petitioner has been allowed to liquidate its security, and as an unsecured creditor will be able to make its claim (against the consolidated assets) for the deficiency. This is nothing less than "what [petitioner] bargained for * * *" (Pet. App. A8).[6]

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[5]None of the cases cited by petitioner holds that a merger or consolidation must be complete for all purposes. In *Kheel, supra,* relied on heavily by petitioner, the enhancement of the government's position as a creditor resulted from a statutory priority contained in the Bankruptcy Act, a congressional expression of policy. The effect of consolidation on the position of Talcott is not governed by any statutory prescription but solely by equitable considerations within the discretion of the bankruptcy court.

[6]If, for example, two related debtors each owned an office building and the same creditor held a separate mortgage on each of those buildings, it would be difficult to imagine circumstances where it would be equitable to permit the creditor to apply the surplus value of one building toward a deficiency in value of the other building, even though the two debtors may have generally been operating as a

The "fair and equitable" requirement of Chapter X[7] means that each class of creditors, in descending rank, should receive full and complete compensation for the rights surrendered before the next lower class may participate. *Consolidated Rock Products Co.* v. *DuBois, supra,* 312 U.S. at 520-521; *Case* v. *Los Angeles Lumber Products Co., Ltd.,* 308 U.S. 106, 116-118. The bankruptcy court, having concluded that petitioner would receive the full benefit of the security for which it had bargained, properly found that the amended plan of reorganization was "fair and equitable" to petitioner within the meaning of Section 221(2) of the Bankruptcy Act, 11 U.S.C. 621 (2).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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single entity. While the liens in this case were not on buildings but on shifting collateral in the hands of the petitioner, there was no showing that petitioner's security had been impaired by the events which required consolidation. Under these circumstances, the bankruptcy court properly refused to allow consolidation, which would have resulted in the petitioner's receiving more security than it bargained for, to the prejudice and detriment of general creditors.

[7]See Sections 174 and 221(2) of Chapter X of the Bankruptcy Act, 11 U.S.C. 574 and 621(2).